

Internal Revenue Service, Treasury

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which class B is entitled to receive in conjunction with the payment to class A of its last \$3 per share is not a preferred dividend, because the payment of such amount is preferred over no subsequent distribution except one made on class B itself. Finally, if a distribution must be \$6 on class A, \$6 on class B, then on class A and class B share and share alike, the distribution on class A of \$6 and the distribution on class B of \$6 are both preferred dividends.

[54 FR 10540, Mar. 14, 1989]

BANKING INSTITUTIONS

Rules of General Application to Banking Institutions

§ 1.581-1 Banks.

(a) In order to be a bank as defined in section 581, an institution must be a corporation for federal tax purposes. See §301.7701-2(b) of this chapter for the definition of a corporation.

(b) This section is effective as of January 1, 1997.

[T.D. 8697, 61 FR 66588, Dec. 18, 1996]

§ 1.581-2 Mutual savings banks, building and loan associations, and cooperative banks.

(a) While the general principles for determining the taxable income of a corporation are applicable to a mutual savings bank, a building and loan association, and a cooperative bank not having capital stock represented by shares, there are certain exceptions and special rules governing the computation in the case of such institutions. See section 593 for special rules concerning reserves for bad debts. See section 591 and §1.591-1, relating to dividends paid by banking corporations, for special rules concerning deductions for amounts paid to, or credited to the accounts of, depositors or holders of withdrawable accounts as dividends. See also section 594 and §1.594-1 for special rules governing the taxation of a mutual savings bank conducting a life insurance business.

(b) For the purpose of computing the net operating loss deduction provided in section 172, any taxable year for which a mutual savings bank, building and loan association, or a cooperative bank not having capital stock represented by shares was exempt from

tax shall be disregarded. Thus, no net operating loss carryover shall be allowed from a taxable year beginning before January 1, 1952, and, in the case of any taxable year beginning after December 31, 1951, the amount of the net operating loss carryback or carryover from such year shall not be reduced by reference to the income of any taxable year beginning before January 1, 1952.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8697, 61 FR 66588, Dec. 18, 1996]

§ 1.581-3 Definition of bank prior to September 28, 1962.

Prior to September 28, 1962, for purposes of sections 582 and 584, the term *bank* means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act (38 Stat. 262; 12 U.S.C. 248(k)), and which is subject by law to supervision and examination by State, Territorial, or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

[T.D. 6651, 28 FR 4950, May 17, 1963]

§ 1.582-1 Bad debts, losses, and gains with respect to securities held by financial institutions.

(a) *Bad debt deduction for banks.* A bank, as defined in section 581, is allowed a deduction for bad debts to the extent and in the manner provided by subsections (a), (b), and (c) of section 166 with respect to a debt which has become worthless in whole or in part and which is evidenced by a security (a bond, debenture, note, certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money) issued by any corporation (including governments and their political subdivisions), with interest coupons or in registered form.

(b) *Worthless stock in affiliated bank.* For purposes of section 165(g)(1), relating to the deduction for losses involving worthless securities, if the taxpayer is a bank (as defined in section 581) and owns directly at least 80 percent of each class of stock of another bank, stock in such other bank shall not be treated as a capital asset.

(c) *Pre-1970 sales and exchanges of bonds, etc., by banks.* For taxable years beginning before July 12, 1969, with respect to the taxation under subtitle A of the Code of a bank (as defined in section 581), if the losses of the taxable year from sales or exchanges of bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), exceed the gains of the taxable year from such sales or exchanges, no such sale or exchange shall be considered a sale or exchange of a capital asset.

(d) *Post-1969 sales and exchanges of securities by financial institutions.* For taxable years beginning after July 11, 1969, the sale or exchange of a security is not considered the sale or exchange of a capital asset if such sale or exchange is made by a financial institution to which any of the following sections applies: Section 585 (relating to banks), 586 (relating to small business investment companies and business development corporations), or 593 (relating to mutual savings banks, domestic building and loan associations, and cooperative banks). This paragraph shall apply to determine the character of gain or loss from the sale or exchange of a security notwithstanding any other provision of subtitle A of the Code, such as section 1233 (relating to short sales). However, this paragraph shall have no effect in the determination of whether a security is a capital asset under section 1221 for purposes of applying any other provision of the Code, such as section 1232 (relating to original issue discount). For purposes of this paragraph, a security is a bond, debenture, note, or certificate or other evidence of indebtedness, issued by any person. See paragraphs (e) and (f) of this section for special transitional rules applicable, respectively, to banks and to small

business investment companies and business development corporations.

(e) *Transition rule for qualifying securities held by banks*—(1) *In general.* Notwithstanding the provisions of paragraph (d) of this section, if the net long-term capital gain from sales and exchanges of qualifying securities exceeds the net short-term capital loss from such sales and exchanges in any taxable year beginning after July 11, 1969, such excess shall be treated as long-term capital gain, but in an amount not to exceed the net gain from sales and exchanges of securities in such year. For purposes of computing such net gain, a capital loss carried to the taxable year under section 1212 shall not be taken into account. See section 1222 and the regulations thereunder for definitions of the terms *net long-term capital gain* and *net short-term capital loss*. For purposes of this paragraph:

(i) The term *security* means a security within the meaning of paragraph (d) of this section.

(ii) The term *qualifying security* means a security which is held by the bank on July 11, 1969, and continuously thereafter until it is first sold or exchanged by the bank

See also subparagraph (4) of this paragraph for rules under which the time certain securities are held is deemed to include a period of time determined under section 1223 (1) and (2) with respect to such security.

(2) *Computation of capital gain or loss.* For purposes of this paragraph, the amount of gain or loss from the sale or exchange of a qualifying security treated as capital gain or loss is determined by multiplying the amount of gain or loss recognized from such sale or exchange by a fraction the numerator of which is the number of days before July 12, 1969, that such security was held by the bank and the denominator of which is the sum of the number of days included in the numerator and the number of days the security was held by the bank after July 11, 1969.

(3) *Special rules.* For purposes of subparagraphs (1) and (2) of this paragraph, the following items are not taken into account:

(i) Any amount treated as original issue discount under section 1232, and

(ii) Any amount which, without regard to section 582(c) and this section, would be treated as gain or loss from the sale or exchange of property which is not a capital asset, such as an amount which is realized from the sale or exchange of a security which is held by a bank as a dealer in securities.

(4) *Holding period in certain cases.* For purposes of this paragraph:

(i) The time a security received in an exchange is deemed to have been held by a bank includes a period of time determined under section 1223(1) with respect to such security.

(ii) The time a security transferred to a bank from another bank is deemed to have been held by the transferee bank includes a period of time determined under section 1223(2) with respect to such security.

For example, if a bank on December 3, 1972, surrendered an obligation of the United States which it held as a capital asset on July 11, 1969, in a transaction to which section 1037 applied, the time during which the newly received obligation is deemed to have been held includes the time during which the surrendered obligation was deemed to have been held by the bank. Because the surrendered obligation was held on July 11, 1969, the newly acquired obligation is deemed to have been held on that date and is a qualifying security. The period during which the surrendered obligation is deemed to have been held is taken into account in computing the fraction determined under subparagraph (2) of this paragraph with respect to the newly received obligation.

(5) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. Bank A, a calendar year taxpayer, purchased a qualifying security on July 14, 1968, and held it to maturity on August 20, 1970, when it was redeemed. The redemption resulted in a taxable gain of \$10,000. The security was held by the bank for 363 days before July 12, 1969, and for a total of 768 days. During the taxable year, the bank had no other gains and no losses from sales or exchanges of qualifying securities, but had a net loss of \$4,000 from sales of securities other than qualifying securities. The portion of the gain from the redemption of the qualifying security treated as capital gain under subparagraph (2) of this para-

graph is \$4,726.56 ($363/768 \times \$10,000$). Because the net gain of the taxable year from sales and exchanges of securities, \$6,000 ($\$10,000 - \$4,000$), exceeds the portion of the gain on the sale of the qualifying security treated as capital gain under this paragraph, \$4,726.56 is treated as long-term capital gain on the sale of the qualifying security for the taxable year.

Example 2. Assume the same facts as in example 1, except that the bank's net loss of the taxable year from the sale of securities other than qualifying securities was \$7,000. The amount considered as long-term capital gain under this paragraph is limited by the amount of gain on the sale of securities to \$3,000 ($\$10,000 - \$7,000$).

(f) *Small business investment companies and business development corporations—*

(1) *Election.* In the case of a small business investment company or a business development corporation, described in section 586(a), section 582(c) does not apply for taxable years beginning after July 11, 1969, and before July 11, 1974, unless the taxpayer elects that such section shall apply. In the case of a small business investment company, see paragraph (a)(1) of § 1.1243-1 if such an election is made, but see paragraph (a)(2) of § 1.1243-1 if such an election is not made. Such election applies to all such taxable years and, except as provided in subparagraph (3) of this paragraph, is irrevocable. Such election must be made not later than (i) the time, including extensions thereof, prescribed by law for filing the taxpayer's income tax return for its first taxable year beginning after July 11, 1969, or (ii) June 8, 1970, whichever is later.

(2) *Manner of making election.* An election pursuant to the provisions of this paragraph is made by the taxpayer by a written statement attached to the taxpayer's income tax return (or an amended return) for its first taxable year beginning after July 11, 1969. Such statement shall indicate that the election is made pursuant to section 433(d) of the Tax Reform Act of 1969 (83 Stat. 624). The taxpayer shall attach to its income tax return for each subsequent taxable year to which such election is applicable a statement indicating that the election has been made and the amount to which it applies for such year.

(3) *Revocation of election.* An election made pursuant to subparagraph (2) of

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this paragraph shall be irrevocable unless:

(i) A written application for consent to revoke the election, setting forth the reasons therefor, is filed with the Commissioner within 90 days after the permanent regulations relating to section 433(d)(2) of the Tax Reform Act of 1969 (83 Stat. 624) are filed with the Office of the Federal Register, and

(ii) The Commissioner consents to the revocation.

The revocation is effective for all taxable years to which the election applied.

[T.D. 7171, 37 FR 5620, Mar. 17, 1972; 37 FR 6400, Mar. 29, 1972]

§ 1.584-1 Common trust funds.

(a) *Method of taxation.* A common trust fund maintained by a bank is not subject to taxation under this chapter and is not considered a corporation. Its participants are taxed on their proportionate share of income from the common trust fund.

(b) *Conditions for qualification.* (1) For a fund to be qualified as a common trust fund it must be maintained by a bank (as defined in section 581) in conformity with the rules and regulations of the Comptroller of the Currency, exclusively for the collective investment and reinvestment of contributions to the fund by the bank. The bank may either act alone or with one or more other fiduciaries, but it must act solely in its capacity as one or a combination of the following: (i) As a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court; (ii) as an executor of a will or as an administrator of an estate; (iii) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual, or of an absent individual; or (iv) on or after October 3, 1976, as a custodian of a Uniform Gifts to Minors account. A Uniform Gifts to Minors account is an account established pursuant to a State law substantially similar to the Uniform Gifts to Minors Act. (See the Uniform Gifts to Minors Act of 1956 or the Uniform Gifts to Minors Act of 1966, as published by the National Conference of Commissioners on Uniform State Laws.) The Commissioner will publish a list of the States whose laws

he determines to be substantially similar to such uniform acts. A bank that maintains a Uniform Gifts to Minors Act account must establish, to the satisfaction of the Commissioner or his delegate, that with respect to the account the bank has duties and responsibilities similar to the duties and responsibilities of a trustee or guardian.

(2) A common trust fund may be a participant in another common trust fund.

(c) *Affiliated groups.* For taxable years beginning after December 31, 1975, two or more banks that are members of the same affiliated group (within the meaning of section 1504) are treated, for purposes of section 584, as one bank for the period of their affiliation. A common trust fund may be maintained by one or by more than one member of an affiliated group. Any member of the group may, but need not, contribute to the fund. Further, for purposes of this paragraph, members of an affiliated group may be, but need not be, co-trustees of the common trust fund.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7935, 49 FR 1694, Jan. 13, 1984]

§ 1.584-2 Income of participants in common trust fund.

(a) Each participant in a common trust fund is required to include in computing its taxable income for its taxable year within which or with which the taxable year of the fund ends, whether or not distributed and whether or not distributable:

(1) Its proportionate share of short-term capital gains and losses, computed as provided in § 1.584-3;

(2) Its proportionate share of long-term capital gains and losses, computed as provided in § 1.584-3; and

(3) Its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in § 1.584-3.

(b) Any tax withheld at the source from income of the fund (e.g., under section 1441) is deemed to have been withheld proportionately from the participants to whom such income is allocated.

(c)(1) The proportionate share of each participant's short-term capital gains and losses, long-term capital gains and